income but the amount of which cannot be specifically identified, regardless of where these expenses are incurred.

A provision could be inserted in Section 882 similar to subsection (d) "Election to Treat Real Property Income as Income Connected with United States Business.—" as set forth in Section 4(b) of H.R. 13103, and might read as follows:

"(e) ELECTION TO TREAT U.S. SOURCE INVESTMENT INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A corporation organized under the banking laws of Puerto Rico (or a foreign country) which during the taxable year derives any income—

"(A) from investment in bonds, notes or other securities issued by the United States, any territory, any political subdivision or agency of the United States or of a territory, or the District of Columbia, and any obligations guaranteed as to interest and principal by any of them, and

"(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States, may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION, ETC.—Paragraphs (2) and (3) of section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871(d)."

The above provision, as in the case of income from real property, would treat this U.S. source interest income as effectively connected with the conduct of a trade or business within the United States and taxed at the regular corporate rates as provided in Section 11 of the Internal Revenue Code together with the income of the bank which is effectively connected with the conduct of its banking business in the United States. Such special treatment for Puerto Rico would not be unique under U.S. concepts of taxation. By way of analogy, Section 876 of the Code provides that Section 871 through 875 (dealing with the taxation of U.S. source income of non-resident alien individual) does not apply to a citizen and bona fide resident of Puerto Rico for an entire taxable year. This means that a Puerto Rican individual coming within this section may claim all ordinary and necessary business expenses incurred in connection with earning taxable income, including U.S. source income, even though such expenses are incurred in Puerto Rico. Inasmuch as the proposed Bill would treat taxable interest income not effectively connected with the conduct of the U.S. trade or business as being earned by a non-resident foreign corporation, and since Section 876 recognizes the deductibility of related expenses by Puerto Rican resident individuals not available to non-resident foreigners, this principle should be extended to Puerto Rican banking corporations as recommended above.

2. Exempt resident foreign banking corporations, or Puerto Rican banks in particular, from Federal income tax on U.S. source investment income. Such action would not set a novel precedent for granting Puerto Rican persons a special status under the Internal Revenue Code. Section 931 of the Code already grants a special tax status to U.S. corporations operating in Puerto Rico, exempting them from U.S. income tax if they meet certain statutory requirements. Furthermore, although Puerto Rican corporations are treated as foreign corporations, for purposes of the controlled foreign corporation provisions of the 1962 Revenue Act, Section 957(c) of the Code provides an exclusion from this status for most Puerto Rican corporations, again recognizing the unique position of such entities with respect to the United States and to Federal taxation. Thus, the above exceptions recognize that Puerto Rico has a special position with respect to the United States and is not to be considered in the same light as a foreign country despite the fact that it administers its own tax laws.